

**UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa**

In re:	:	Case No. 02-2729-rjh-7
	:	
RITA S. MARTENS,	:	Chapter 7
	:	
Debtor.	:	

RITA S. MARTENS,	:	Adv. No. 02-20117
	:	
Plaintiff,	:	
	:	
v.	:	
	:	
HOUSEHOLD FINANCE	:	
INDUSTRIAL LOAN COMPANY OF	:	
IOWA,	:	
	:	
Defendant.	:	

**ORDER—COMPLAINT TO DETERMINE THE VALIDITY OF LIEN
AND COUNTERCLAIM**

The trial of the above adversary proceeding was held on May 10, 2004. H. J. Dane represented the plaintiff Rita S. Martens. Mark D. Walz and LeGrand W. Smith represented the defendant Household Finance Loan Company of Iowa. At the conclusion of the trial, the court took the matter under advisement.

The court has jurisdiction of these matters pursuant to 28 U.S.C. §§ 157(b)(1) & 1334 and order of the United States District Court for the Southern District of Iowa. These are core proceedings pursuant to 28 U.S.C. § 157(b)(2)(B) & (K). Upon review of the pleadings, evidence, briefs, and arguments of counsel, the court now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. Rita Martens (hereinafter Martens) purchased her home at 1708 Alcoa Ave., Bettendorf, Iowa in July 1977. She continues to reside in that home.
2. Martens is a single adult person without dependents. She was employed as a bookkeeper for 19 years but that employment terminated when new management took over the business. She is currently employed earning \$10.00 per hour.
3. Household Finance Industrial Loan Company of Iowa (hereinafter Household) is an Iowa corporation engaged in the business of making consumer loans, including mortgage loans. Household enters into more than five transactions per year in which credit is extended that is secured by the principal residence of a consumer and is used for purposes other than the initial acquisition or construction of the residence.
4. Martens had a loan with Household which she was paying off by making monthly payments.
5. Household sent correspondence to Martens which advertised the consolidation of debt loans.
6. Martens went to the Household office in Davenport, Iowa, to get a loan. She gave Household financial information.
7. Household then proceeded to determine Martens' outstanding debt and title to her home.
8. On September 22, 1999, Martens returned to the Household office. On that date Household, as lender, and Martens, as borrower, entered into a Home Equity Credit Line Revolving Loan Agreement (hereinafter the Loan Agreement).

9. This loan was an open-ended mortgage loan with an initial annual percentage rate of 11.9% and a credit limit of \$35,000.00. It recites in bold print that "You are giving us a security interest in the real estate located at the above address." That address was shown as 1708 Alcoa Ave., Bettendorf, IA 52722.

10. Contemporaneous with the execution of the Loan Agreement, Martens, as mortgagor, and Household, as mortgagee, entered into a mortgage.

11. The mortgage gave Household a security interest in the real estate located at 1708 Alcoa Ave., Bettendorf, IA 52722, which is described as follows: Lot 3 in Block 3 in Broadview Heights Subdivision to the City of Bettendorf.

12. Contemporaneous with the execution of Loan Agreement and Mortgage, Household provided Martens with a Notice of Right to Cancel.

13. Martens was given unsigned copies of all documents, including two copies of the Notice of Right to Cancel. Martens certified on September 22, 1999, that she received the Notice of Right to Cancel in duplicate.

14. Paragraph 3 of the Notice of Right to Cancel has two paragraphs which read as follows:

New Loan: You are entering into a transaction that will result in a mortgage, lien or security interest on your home. You have a legal right under federal law to cancel this transaction as stated above. If you cancel this transaction, the mortgage, lien or security interest is also canceled. Within 20 calendar days after we receive your notice, we must take the steps necessary to reflect the fact that the mortgage, lien or security interest on your home has been canceled and we must return to you any money or property you have given to us or to anyone else in connection with this transaction.

Refinancing Existing Loan: You are entering into a new transaction to increase the amount of credit previously provided to you by us. Your home is the security for this new transaction. You have a legal right under federal law to cancel this transaction as stated above. If you cancel this

new transaction, it will not affect any amount that you presently owe. Your home is already the security for that amount. Within 20 calendar days after we receive your notice of cancellation of this new transaction, we must take the steps necessary to reflect the fact that your home does not secure the increase of credit. We must also return any money you have given to us or anyone else in connection with this new transaction.

15. At the time Martens received the Notice of Right to Cancel on September 22, 1999, neither the box labeled "New Loan" nor the box labeled "Refinancing Existing Loan" were checked.

16. Martens also signed on September 22, 1999, a Revolving Loan Voucher in which she directed the following disbursements:

HFC on existing account	\$	4,077.45
Citibank	\$	3,605.00
Discover CD	\$	4,341.00
First Card	\$	4,667.00
Mercantile	\$	9,668.00
Shell MC	\$	4,870.00
Origination fee	\$	700.00
Annual Fee	\$	15.00
Recording fees	\$	26.00
Cash to Rita	\$	3,745.55
Total Advances	\$	35,715.00

17. On September 27, 1999, Martens returned to the Household office in Davenport. On this date Martens certified as follows: "I certify that the date is 9/27/99, and that three or more business days have elapsed from the date on which I received in duplicate this notice of Right to Cancel and executed the loan contract to which this Notice refers and that I have not cancelled this contract."

18. On September 27, 1999, the new loan paragraph was marked with an "X" on the Notice of Right to Cancel and Household advanced \$35,715.00. The original of the Notice of Right to Cancel was retained by Household and Martens retained a copy.

19. On December 28, 1999, Martens called the Household office and complained about the cost of credit and life insurance, which was provided for in the loan agreements. Household cancelled those policies. Martens also wanted to know what the payoff amount was.

20. On December 29, 1999, Household advised Martens that the payoff amount was \$39,870.00. Martens advised Household that she knew about the pre-pay penalty but she did not care, as she wanted to refinance the debt.

21. On March 19, 2000, Household advised Martens that she was eligible to skip one payment.

22. On September 24, 2001, counsel for Martens wrote a letter to Household advising Household the Notice of Right to Cancel was defective, and she therefore had a continuing right to cancel her mortgage and her mortgage note. Household was advised that Martens canceled and rescinded her mortgage and mortgage loan for violations of the Federal Truth and Lending Law.

23. Martens filed her chapter 7 petition on May 20, 2002. Household was scheduled as an unsecured creditor with a claim of \$37,333.00, in that a second mortgage was rescinded.

24. Martens has paid \$16,223.00 to Household.

25. Martens is unable to pay the balance due except by time payments.

DISCUSSION

Martens commenced this adversary proceeding alleging Household violated provisions of the Truth in Lending Act, 15 U.S.C. §§ 1601-1662 (hereinafter TILA) and Regulation Z, 12 C.F.R. §§ 226.1-.1002. Martens contends that Household failed to

provide her with adequate notice of her right to rescind their credit agreement, thereby effectively, extending her right to rescind to three years after the date of the transaction. Martens notified Household that she was exercising her right to rescind the agreement within the extended time period. Martens now seeks a determination by the court that the notice provided by Household was defective, her notice was effective to cancel the credit agreement, and the agreement and Household's security interest in her home is void. Martens additionally seeks a determination that Household's claim from the loan proceeds provided to Martens constitutes an unsecured debt that was discharged in her no asset bankruptcy case. Finally, Martens seeks statutory damages, costs, and attorney fees under TILA.

Congress enacted TILA to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." 15 U.S.C. § 1601. In the Act, Congress also afforded consumers with the opportunity to reflect on the providence of entering into the credit agreement, and the right to rescind the transaction solely upon notice of cancellation within the prescribed period. 15 U.S.C. § 1635 provides in relevant part:

(a) Disclosure of obligor's right to rescind.

Except as otherwise provided in this section, in the case of any consumer credit transaction (including opening or increasing the credit limit for an open end credit plan) in which a security interest, including any such interest arising by operation of law, is or will be retained or acquired in any property which is used as the principal dwelling of the person to whom credit is extended, the obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms required under this section together with a statement containing the material disclosures required under this subchapter, whichever is later, by notifying the creditor, in accordance with regulations of the Board, of his intention to do so. The creditor shall clearly and conspicuously disclose, in accordance with regulations of the Board, to any obligor in a transaction subject to this section the rights of the obligor under this section. The creditor shall also

provide, in accordance with regulations of the Board, appropriate forms for the obligor to exercise his right to rescind any transaction subject to this section.

* * *

(h) Limitation on rescission

An obligor shall have no rescission rights arising solely from the form of written notice used by the creditor to inform the obligor of the rights of the obligor under this section, if the creditor provided the obligor the appropriate form of written notice published and adopted by the Board, or a comparable written notice of the rights of the obligor, that was properly completed by the creditor, and otherwise complied with all other requirements of this section regarding notice.

15 U.S.C. § 1635(a) & (h).

In 15 U.S.C. § 1604, Congress provided the Board of Governors of the Federal Reserve System (hereinafter the Federal Reserve Board) with the authority to prescribe regulations to carry out the purposes of TILA. “Pursuant to this authority, the Federal Reserve Board promulgated ‘Regulation Z’ which is located in 12 C.F.R. Pt. 226.”

Williams v. BankOne, N.A. (In re Williams), 291 B.R. 636, 643 (Bankr. E.D. Pa. 2003).

The parties agree that the transaction in question involves “closed end credit” as opposed to an “open end credit.” See 12 C.F.R. § 226.2(10) & (20) (definitions). In this context, Regulation Z provides in part relevant:

(a) Consumer's right to rescind.

(1) In a credit transaction in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind the transaction, except for transactions described in paragraph (f) of this section. [FN47]

[FN47] For purposes of this section, the addition to an existing obligation of a security interest in a consumer's principal dwelling is a transaction. The right of rescission applies only to the addition of the security interest and not the existing obligation. The creditor shall deliver the notice required by paragraph (b) of this section but need not deliver new material disclosures. Delivery of the required notice shall begin the rescission period.

(2) To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission or, if sent by other means, when delivered to the creditor's designated place of business.

(3) The consumer may exercise the right to rescind until midnight of the third business day following consummation, delivery of the notice required by paragraph (b) of this section, or delivery of all material disclosures, [FN48] whichever occurs last. If the required notice or material disclosures are not delivered, the right to rescind shall expire 3 years after consummation, upon transfer of all of the consumer's interest in the property, upon sale of the property, whichever occurs first. In the case of certain administrative proceedings, the rescission period shall be extended in accordance with section 125(f) of the act.

[FN48] The term "material disclosures" means the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total payments, the payment schedule, and the disclosures and limitations referred to in § 226.32(c) and (d).

* * *

(b)(1) Notice of right to rescind.

In a transaction subject to rescission, a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind (one copy to each if the notice is delivered by electronic communication as provided in § 226.36(b)). The notice shall be on a separate document that identifies the transaction and shall clearly and conspicuously disclose the following:

- (i) The retention or acquisition of a security interest in the consumer's principal dwelling.
- (ii) The consumer's right to rescind the transaction.
- (iii) How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business.
- (iv) The effects of rescission, as described in paragraph (d) of this section.
- (v) The date the rescission period expires.

(2) Proper form of notice. To satisfy the disclosure requirements of paragraph (b)(1) of this section, the creditor shall provide the appropriate model form in Appendix H of this part or a substantially similar notice.

* * *

12 C.F.R. § 226.23(a) & (b).

Regulation Z requires that a creditor provide the borrower with two copies of the notice of the right to rescind. 12 C.F.R. 226.23(b)(1). The notice must be either the model form provided in Appendix H or one that is substantially similar. 12 C.F.R. § 226.23(b)(2). Appendix H-8 provides the following as the model form:

NOTICE OF RIGHT TO CANCEL

Your Right to Cancel

You are entering into a transaction that will result in a [mortgage/lien/security interest] [on/in] your home. You have a legal right under federal law to cancel this transaction, without cost, within three business days from whichever of the following events occurs last:

- (1) the date of the transaction, which is _____; or**
- (2) the date you received your Truth in Lending disclosures; or**
- (3) the date you received this notice of your right to cancel.**

If you cancel the transaction, the [mortgage/lien/security interest] is also cancelled. Within 20 calendar days after we receive your notice, we must take the steps necessary to reflect the fact that the [mortgage/lien/security interest] [on/in] your home has been cancelled, and we must return to you any money or property you have given to us or to anyone else in connection with this transaction.

You may keep any money or property we have given you until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may offer to return the property at your home or at the location of the property. Money must be returned to the address below. If we do not take possession of the money or property within 20 calendar days of your offer, you may keep it without further obligation.

How to Cancel

If you decide to cancel this transaction, you may do so by notifying us in writing, at

(creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and

signing below. Keep one copy of this notice because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of _____ (date) (or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL

Consumer's Signature

Date

12 C.F.R. Pt. 226, App. H.

In this case, the threshold question for the court is whether or not the notice of the right to rescind that Household provided to Martens was so deficient as allow Martens to rescind the agreement well after the three day “cooling off” period, but before three year period provided by 12 C.F.R. 226.23(b)(2). The parties agree that Household provided Martens with two copies of a notice of the right to rescind the transaction. They also agree that neither box was checked on the Notice of Right to Cancel that Martens received on September 22, 1999. Martens asserts that this omission is sufficient to support a right to rescind the transaction. The court disagrees.

TILA requires that an obligor be given notice of the right to rescind the transaction. Regulation Z outlines the procedure and provides a model form that may be used. It also states that a form substantially similar to the model form may be used. 12 C.F.R. § 226.23(b)(2). Further, TILA provides that no recession rights will arise based on the form of the written notice if the form of said notice is substantially similar to the model form provided by the Federal Reserve Board. 15 U.S.C. § 1635(h).

After reviewing the form in question, the court determines that it is substantially similar to the model form provided in Appendix H-8. The most significant difference being the text of the two statements in paragraph 3 of Household's notice. These paragraphs identify the transaction as being either a new loan or the refinancing of existing credit. They then proceed to provide the information set forth in the third paragraph of the model notice.

The court does not place a great deal of significance to the lack of a check mark in the September 22 notice, identifying which paragraph pertained to Martens' transaction. Martens knew that she did have existing outstanding credit with Household which was not secured by her home. She did know that she was receiving a new loan. Therefore, a reasonable person would know that the "new loan" paragraph and not the "refinancing existing loan" loan pertained to this transaction. Consequently, even if Household was dilatory in failing to check the appropriate box, the court finds this mistake to be a harmless error. Accordingly, Martens' right to rescind the contract expired at midnight, September 25, 1999.

Further, the court notes that the notice provided on September 27, 1999, had the appropriate box marked. So, at the latest, Martens was on notice of the right to rescind on that date. Therefore, in the alternative, the court finds that at the latest, Martens had notice of her right to rescind on September 27, 1999. Therefore, pursuant to 12 C.F.R. § 226.23(a)(3), the latest that she could rescind the transaction was midnight on September 30, 1999.

The court determines Martens' written notice to Household, dated September 24, 2001, was untimely and ineffective to rescind the credit transaction. Based on this

conclusion, the court determines that Household did not violate the TILA provisions on disclosure, and no sanctions are warranted. Further, Household retains a valid mortgage on Martens' real property pursuant to their agreement. Accordingly, Martens' claims for relief will be denied in their entirety, and the complaint shall be dismissed.

Finally, the court determines that its decision resolving the alleged TILA violation effectively moots Household's counterclaim asking that Martens be required to return the loan proceeds before making the recession effective and voiding its security interest. Accordingly, Household's counterclaim will be dismissed.

ORDER

IT IS THEREFORE ORDERED that Defendant Household Finance Company of Iowa shall have judgment dismissing Plaintiff Rita S. Martens' complaint with prejudice.

IT IS FURTHER ORDERED that Defendant's counterclaim is dismissed as moot.

Dated: _____, 2004.

RUSSELL J. HILL, JUDGE
U.S. BANKRUPTCY COURT